MINUTES
OF THE MONETARY COUNCIL MEETING
27 SEPTEMBER 2022

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Article 3 (1) of the Central Bank Act (Act CXXXIX of 2013 on the Magyar Nemzeti Bank) defines the achievement and maintenance of price stability as the Magyar Nemzeti Bank's primary objective. The MNB's supreme decision-making body is the Monetary Council. The Council convenes as required by circumstances, but at least twice a month, according to a pre-announced schedule. At the second scheduled meeting each month, members consider issues relevant to decisions on interest rates. Abridged minutes of the Council's rate-setting meetings are released regularly, before the next policy meeting takes place. The minutes present the decision-makers' assessment of current economic conditions and the factors they consider when deciding on the base rate. Until December 2013, the Monetary Council presented the information underlying its assessments as part of the abridged minutes. In order to provide more detailed information, background materials will henceforth appear as a separate publication with enhanced content under the title 'Macroeconomic and financial market developments', at the same time as the abridged minutes.

The minutes are available on the MNB's website at:
http://www.mnb.hu/en/monetary-policy/the-monetary-council/minutes

THE COUNCIL'S ASSESSMENT AND INTEREST RATE DECISION

The primary objective of the Magyar Nemzeti Bank (MNB) is to achieve and maintain price stability. Without prejudice to its primary objective, the Magyar Nemzeti Bank preserves financial stability and supports the Government's economic policy, as well as its policy on environmental sustainability.

The risk of recession in the global economy had increased due to the prolonged Russia-Ukraine war and the European energy crisis. High commodity prices and the drought in Europe might push inflation up further over the short term; however, the first signs of a turnaround had appeared. Growing recession risks, alongside falling commodity and energy prices and transport costs, pointed to a moderation in global inflation from 2023.

Investor sentiment had deteriorated in general. Risk appetite had been driven by news on the war, expectations for interest rate increases by the world's leading central banks, concerns caused by persistently high inflation and fears of recession. Global prices of most commodities had fallen recently but remained at high levels. Gas futures prices had fallen since September, exhibiting considerable volatility. The US dollar had continued to appreciate against the currencies of both developed and emerging economies.

Both the Federal Reserve and the European Central Bank had raised interest rates by 75 basis points in September. Meanwhile, CEE central banks had begun to slow or halt their cycle of interest rate hikes started well before those of the world's leading central banks. The Polish central bank had raised its base rate by 25 basis points in September and rendered additional steps conditional upon incoming data. The Czech central bank had stopped tightening interest rate conditions in August, and the Romanian central bank had raised its policy rate by 75 basis points, by a lesser extent than expected by the market.

In the first half of 2022, the Hungarian economy had grown strongly; however, high-frequency data indicated a clear economic slowdown since the beginning of June. Industrial production and construction output had increased on a year-on-year basis in July. Retail turnover had stagnated after monthly decreases experienced since April. The labour market continued to be tight. However, the global economic slowdown and the effects of high energy prices were increasingly reflected in a general deterioration in sentiment indicators.

The time profile and structure of domestic GDP growth had been characterised by strong duality in 2022. The rate of annual economic growth was likely to slow significantly in the second half of the year. The components of domestic demand were expected to contribute to growth throughout this year. By contrast, net exports were likely to hold back the expansion. In 2023, household consumption would decrease. Rising costs and more uncertain demand prospects would reduce corporate investments, while the rescheduling of public development projects would also restrain investment activity. Net exports were expected to make a positive contribution to GDP growth again from the end of 2023 as external markets and supply chains recovered. Hungary's GDP was expected to grow by 3.0–4.0 percent in 2022, by 0.5–1.5 percent in 2023, and by 3.5–4.5 percent in 2024.

In August 2022, annual inflation had been 15.6 percent and core inflation had stood at 19.0 percent. Inflation had risen by 1.9 percentage points, mainly due to an increase in food prices. Processed food prices had been the main contributing factor to the increase in core inflation. The rise in producer prices had almost completely passed through to retail prices. Inflation expectations were at elevated levels.

Inflation was expected to rise further in the autumn months, mainly due to factors outside the scope of monetary policy. The exceptional drought, the price explosion in energy markets and changes in official energy price regulations had all caused a short-term rise in inflation. The extension of measures aimed at capping prices until 1 January 2023 was likely to restrain price increases until the end of the year.

The easing of external inflationary pressures and the downward pressure on prices, resulting from slowing demand, was expected start feeding through to domestic inflation from early 2023, leading to a slow turnaround in price growth. The expected decline in freight costs, commodity and energy prices based on futures prices, as well as the slowdown in global economic growth would all have a downward effect on external inflation. At the same time, declining consumer demand had an increasingly strong constraining effect on companies' pricing decisions. Tight monetary conditions helped to avoid second-round inflationary effects and anchor inflation expectations. The consumer price index might average between 13.5–14.5 percent in 2022. Domestic inflation would decrease slowly in the first half of 2023, and then more significantly from the middle of the year. The consumer price index would return to the central bank tolerance band in the first half of 2024.

The measures announced by the Government and their implementation were expected to ensure the achievement of this year's budget deficit target indicated by the Ministry of Finance. Thus, the government debt-to-GDP ratio would decrease to close to 76 percent of GDP by the end of 2022. The current account deficit was expected to continue rising temporarily in 2022 due to the import-increasing effect of high energy prices. Apart from the deterioration of the energy balance, an overall improvement could be observed in other items of the balance of payments. By 2024, with the normalisation of the global economic environment and the pick-up of the production of significant new export capacities built in recent years, the external balance position was expected to improve rapidly and significantly.

Following the review of macroeconomic and financial market developments as well as the Inflation Report projection, the Monetary Council discussed the details of its monetary policy decision. Members agreed that risks to global recession had recently increased. Several decision makers pointed out the signs of a turnaround in global inflation, as prices of major raw materials and energy commodities had fallen significantly compared to their peak levels and transport costs had also moderated recently. Some mentioned that inflation had been falling in a growing number of EU countries as well.

Council members agreed that risks to the outlook for domestic economic growth were on the downside. Decision makers emphasised that the structure of domestic GDP growth had been characterised by strong duality in 2022. Although economic growth had been strong in the first half of the year, the clear signs of a slowdown had been seen in high-frequency data since June. Some Council members also underlined that the increase in the current account deficit had largely resulted from the import-increasing effect of high energy prices, while factors other than energy items led to an improvement in external balance.

Decision makers expected domestic inflation to rise further in the autumn months, largely arising from changes in the official energy price regulation and food price increases due to the drought. Both factors were outside the scope of monetary policy. The decrease in global inflation and the downward pressure on prices resulting from slowing demand might become increasingly pronounced in domestic inflation from early 2023. Due to the increasing base effect, consumer price index was expected to slow down significantly from the middle of 2023 before returning to the central bank tolerance band in 2024 according to the baseline forecast. The Monetary Council assessed four risk scenarios. Based on these, in the Council members' assessment, risks to the outlook for inflation had become symmetric.

Council members agreed that in terms of achieving the inflation target, it was still crucial to avoid second-round effects and to anchor inflation expectations, which required a sustained tight monetary policy. Decision makers stressed that the Bank's tight monetary policy was based on two pillars: a tight interest rate policy and strengthening monetary policy transmission by draining a significant amount of liquidity.

Monetary Council members agreed that tightening monetary conditions was warranted by taking a decisive step in September. Members were of the view that this would ensure a sufficiently tight interest rate environment with the September interest rate move in addition to the steps taken so far. In context of the projection in the September Inflation Report and the risk distribution around it, members decided to stop the cycle of base rate hikes. Several members stressed that the maintenance of a restrictive interest rate environment would ensure that inflation remained on a sustained downward path and inflation expectations stayed anchored.

Decision makers underlined that the termination of the cycle of base rate hikes did not imply a change in the Bank's monetary policy stance. The Monetary Council would continue the tightening of monetary conditions by draining interbank liquidity. Some members pointed out that the MNB would significantly drain interbank liquidity from 1 October by raising the reserve requirement ratio, by regularly announcing discount bond auctions and by introducing a long-term deposit instrument. Decision makers noted that the increased required reserve ratio was expected to tie up significantly more liquidity, close to HUF 2,700 billion, compared to the earlier expectation of HUF 1,800 billion. Several members stressed that, if the new instruments had been properly utilised, the stock of the one-week deposit instrument could have been reduced by more than 50 percent. Based on market developments since the measures had been announced, Council members established that, due to liquidity-absorbing measures, short-term money market interest rates were following the rising base rate more closely. Council members also noted that the continued enhancement of monetary policy transmission was expected to help ensure that the high domestic base rate was more strongly reflected in all sub-markets. Some members pointed out that, looking ahead, the central bank might use additional tools to drain interbank liquidity and tighten monetary conditions further.

Council members highlighted that the Hungarian economy was surrounded by a rapidly changing geopolitical and risk environment. Developments regarding the EU funds had pointed to a clear progress, therefore the Monetary Council expected that an agreement would be reached this year regarding funds from the European Union.

Decision makers agreed that the above factors support the termination of the cycle of base rate hikes overall, as raising the base rate by taking a decisive step in September, ensured the achievement of the inflation target in a sustainable manner over the monetary policy horizon. Council members were of the view that stopping the interest rate hikes in one decisive step is consistent with the Bank's tight monetary policy and the maintenance of the current interest rate level on a sustained basis was expected to create a predictable interest rate environment. In addition, several members stressed that the tightening of monetary conditions would continue by significantly draining interbank liquidity after ending the interest rate hikes.

The Monetary Council reviewed real economic and financial market developments, as well as the past and potential future outcomes of the cycle of interest rate hikes. Based on these, the Council decided to make a decisive interest rate step in September.

According to today's decision of the Monetary Council, the central bank base rate was raised by 125 basis points to 13.00 percent. The overnight deposit rate was increased by 125 basis points to 12.50 percent, and the overnight and the one-week collateralised lending rates were increased by 125 basis points to 15.50 percent. According to the Monetary Council's assessment, it was warranted to increase the interest rate on the one-week deposit instrument by the same measure as in the base rate.

The Magyar Nemzeti Bank had been among the first institutions to start the tightening of monetary conditions, raising the base rate by over 12 percentage points since June 2021. With this, interest rate conditions had become sufficiently strict. The tightening of monetary conditions continued with the tightening of liquidity.

From October 1, the MNB would significantly reduce forint liquidity by raising the required reserve ratio, holding central bank discount bond auctions regularly and launching a longer-term deposit instrument. In addition, the MNB also increased the effectiveness of monetary transmission through increases in swap yields using tenders providing foreign currency liquidity held on a daily basis. These measures would tighten monetary conditions even further, so the disinflationary effect of the previous base interest rate hikes would increase considerably.

The Monetary Council deemed that the risk distribution around the inflation projection of the September Inflation Report had become symmetrical. The alternative scenarios assuming the possibility of slowing global economic activity and a larger reversal in energy and commodity prices implied lower inflation than the baseline, and the scenarios assuming energy and commodity prices remaining at higher levels and strengthening second-round inflationary effects pointed to higher inflation. Overall, the growth risks pointed to a lower GDP trajectory.

In the Monetary Council's assessment, by the current level of the base rate, interest rate conditions had become sufficiently strict, which ensured the achievement of the inflation target. The Monetary Council had decided to stop the cycle of base rate hikes after the step in September. Tight monetary conditions would be maintained over a prolonged period, which would ensure that inflation expectations were anchored and the inflation target was achieved in a sustainable manner. Looking ahead, tightening liquidity and further enhancing monetary transmission would be in the MNB's focus, for which the central bank might decide on additional measures in the future.

Votes cast by individual members of the Council:

In favour of raising the base rate to 13.00 percent, the overnight collateralised lending rate and the one-week collateralised lending rate to 15.50 percent **and** **increasing the interest rate on the overnight central bank deposit to 12.50 percent:**	9	Péter Gottfried, Csaba Kandrács, Kolos Kardkovács, György Kocziszky, György Matolcsy, Bianka Parragh, Mihály Patai, Gyula Pleschinger, Barnabás Virág
Vote against:	0	

The following members of the Council were present at the meeting:

Péter Gottfried

Csaba Kandrács

Kolos Kardkovács

György Kocziszky

György Matolcsy

Bianka Parragh

Mihály Patai

Gyula Pleschinger

Barnabás Virág

The Council will hold its next policy meeting on 25 October 2022. The minutes of that meeting will be published at 2 p.m. on 9 November 2022.